

**BRIEF IN SUPPORT OF PETITION
OPINIONS BELOW**

The opinion of the Tax Court (R. 16-28) is not officially reported. The opinion of the Circuit Court of Appeals for the Eighth Circuit is not yet officially reported but may be found in 444 C. C. H. par. 9213.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 16, 1944. (R. 43.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED, STATUTES INVOLVED, ETC.

A statement of the questions presented, specification of errors, a statement of the case, and the statutes and regulations involved are set out in the petition.

ARGUMENT

**The Statutory Phrase "Amounts Which Can Be Distributed"
Does Not Include the Taxpayer's Own Capital Stock**

First. The purpose of a contract prohibiting payment of dividends is to provide security for creditors or others holding obligations prior to the claims of shareholders. The creditor of a corporation is not normally concerned with whether his debtor distributes shares of its capital stock, for any claims thereby accruing are subordinate to his own, and hence share-distributions are usually not prohibited in such contracts.

For this reason an interpretation of the statutory phrase as including share-distributions leaves little if anything upon which the statute can operate, and violates the oft-reiterated rule that, where another interpretation is reasonably possible, a statute should not so be construed as to deprive it of all practical utility and leave it a nullity.

Second. The Circuit Court of Appeals in this cause assumed (R. 38:39) that it was called upon to construe the word "dividends". This is error; the critical word is "amounts", and this refers to earnings and profits.

"Amounts of earnings and profits" is the phraseology used in subdivision (2) of Section 26 (c), which is *in pari materia* with subdivision (1), the provision here in issue, since, as their common title "Contracts Restricting Payment of Dividends" indicates, the two "deal with precisely the same subject matter" (*United States v. Stewart*, 311 U. S. 60, 64), namely, the allowance of credit by reason of restrictive contracts. "Earnings and profits" in subdivision (2) can be represented only by the corporate debtor's property; it is only that, not the power to declare stock dividends, which can discharge indebtedness. Similarly, "amounts" in subdivision (1) can be represented only by the corporate

debtor's property; for earnings are retained for the security of creditors, not by failure to declare stock dividends, but only when the corporation's property is not distributed.⁵

Third. Legislative history supports the construction urged by the petitioner. As originally proposed, Section 26 (c) (1) provided for a credit only if there was "no form in which dividends" could be paid. H. R. 12395, Section 15 (a), 74th Cong., 2nd Sess. It was changed to its present language on the floor of the Senate. 80 Cong. Rec. 9071. In explaining the change, Senator LaFollette, one of the Conference Managers on the part of the Senate, said that the new provision was "a much broader and more liberal" one than that originally proposed. 80 Cong. Rec. 10470. The only possible liberalization of any substantial consequence was to remove the condition that credit was allowable only if there was "no form" in which dividends could be paid.⁶

Furthermore, in explaining one of the amendments of Section 26 made by Section 501 (a) of the Revenue Act of 1942, the Senate Committee on Finance explained in its report that the purpose was to afford relief to certain corporate taxpayers which did not have "sufficient assets" to make distributions permitting escape from the surtax on undistributed profits. S. Rep. 1631, 77th Cong., 2nd Sess., p. 245.

⁵Even if "dividends" rather than "amounts" be deemed the critical word, it should be construed to include only asset-distributions, for only so can the usefulness of the statute be preserved. That is the commonly-understood meaning of the word, its "business" sense. That is the sense in which the word has many times been employed by this Court. See *Lynch v. Hornby*, 247 U. S. 339, 346.

In this connection it may be observed that the Circuit Court of Appeals in this cause departed from the technical definition of dividends by reading into Section 26 (c) (1) that part of the statutory definition contained in subdivision (a) of Section 115 but not that part contained in subdivision (f) (1) of the same section. (R. 39-40.) If "dividends" is not to be given its technical meaning, then it ought to be given its business meaning; there is neither logic in nor occasion for taking a middle ground and working out a sort of hybrid.

⁶In his brief in opposition in the *Valentine-Clark* case (No. 644) the respondent suggests (p. 10, note 1) that the liberalization referred to by the Senator may have been the substitution of the date May 1, 1936, for the date March 3, 1936. It taxes one's credulity to believe that this is what made the substituted provision "much broader and more liberal" than the original provision.

"Assets" clearly means property, and if "amounts which can be distributed" be not limited to asset-distributions, the enactment of the 1942 amendment was quite pointless.

Fourth. There are practical considerations which lend persuasive support to the petitioner's interpretation of the statute. Illustrative is the fact that, under the view of the Circuit Court of Appeals, in order to avoid the surtax the petitioner would have been compelled to give notice to not less than 17,660 shareholders, hold a special meeting of shareholders, induce them to consent to amendment of the charter so as to create a class of preferred stock, distribute 3,600 of the new shares assuming a \$100 market value per share (about 1/44 of a share of the new stock on each old share, or about 1/5 of a share on an average to each shareholder), and do such other numerous things, large and small, as are incident to a recapitalization.

Nor would that have been sufficient. Since the distribution of preferred shares would not have disturbed the proportionate interests of the shareholders, the new shares would not have been taxable. *Helvering v. Sprouse*, 318 U. S. 604. And so the petitioner would have been compelled, in advance of the distribution, either to make a gift to outsiders of some of the newly-authorized shares (which would have been unlawful) or, subject to the provisions of the Securities Act of 1933 and of applicable state securities laws, to shop around for buyers (for whose capital it probably would have had no profitable use).

Nor would all this have sufficed if, as might well have been the case, the petitioner's income had been represented by capital gains realized so late in the year as to have made such a program as the foregoing impossible of consummation before the end of the taxable period.

Pertinent under the circumstances is what this Court said in *Woolford Realty Co. v. Rose*, 286 U. S. 319, 329:

Doubt, if there can be any, is not likely to survive a consideration of the mischiefs certain to be engendered by any other ruling. ***

In Any Event, the Statutory Phrase "Amounts Which Can Be Distributed" Does Not Include Non-Taxable Stock Distributions

We have pointed out that the critical word is "amounts", not "dividends". Were it otherwise, however, the result should nevertheless be the same.

If "dividends" as used in Section 26 (c) (1) is not to be understood in its "business" sense as denoting only asset-distributions,⁷ it seems that the only logical alternative is to accept it as defined technically in the Act. The technical definition is contained in Section 115, subdivision (a) of which defines "dividends" as meaning any distribution out of earnings and profits, and subdivision (f) (1) of which excepts therefrom non-taxable stock distributions.

However, while rejecting the "business" definition for purposes of Section 26 (c) (1), the Circuit Court of Appeals did not accept the technical definition, at least not in full. Instead, in connection with the altogether questionable statement that that part of the definition appearing in subdivision (a) of Section 115 includes non-taxable as well as taxable stock distributions, it concluded that in construing "dividends" in Section 26 (c) (1), no regard should be had for that part of the definition contained in subdivision (f) (1) of Section 115. (R. 39-40.)

The only justification advanced for this excising of the definition is a theory that subdivision (f) (1) is of consequence only in respect of shareholders who receive stock dividends, not in respect of the corporations which pay them. (R. 40.) This theory is completely refuted by subdivision

⁷See note 5, *supra*.

(h) (2) of Section 115, which provides that non-taxable stock distributions do not reduce the paying corporation's earnings and profits. The clear consequence is that a non-taxable stock distribution is not an amount "which can be distributed *** as dividends" within the meaning of Section 26 (c) (1).⁸

The Petitioner Was Prohibited by Contract from Making Non-Taxable Stock Distributions

This Court held in the *Northwest Steel* case that a corporate charter is not a "contract" within the meaning of that word as used in Section 26 (c) (1), and that therefore a prohibition against dividends existing only by reason of charter provision does not warrant allowance of credit under that section.

In the present cause there was such a contract as the statute requires. However, because it allowed stock dividends without discriminating in terms between taxable and non-taxable stock dividends,⁹ and because only upon examination of the petitioner's charter does it become apparent that the petitioner was not empowered to pay taxable stock dividends, the Circuit Court of Appeals held (R. 41-42) that there was no contractual prohibition against payment of such dividends within the meaning of Section 26 (c) (1) and that the case falls within the doctrine of the *Northwest Steel* decision.

⁸The Circuit Court of Appeals supported its holding that ability to pay non-taxable stock dividends deprives the taxpayer of credit under Section 26 (c) (1) with the statement (R. 38, 40) that this accords with the administrative interpretation evidenced by Regulations 94, Art. 26-2, *supra*. This statement is correct only if it be assumed that the regulation uses the word "dividend" as having a meaning different from that given it by Section 115 (a) and (f) (1). There is no foundation for any such assumption. Indeed, the fact seems to be to the contrary; in the present cause, for example, the Commissioner did not deny the credit on the ground that the taxpayer could pay stock dividends, but on the ground (R. 12) that the taxpayer could pay "taxable" stock dividends.

⁹A discrimination which we venture to suggest no prohibitory contract has ever made.

This is specious reasoning. Where a contract prohibits the payment of all dividends except stock dividends, both the prohibition and the exception are contractual. One looks outside the contract only to find the limits or meaning of the exception, and where share-distributions are excepted from the operation of the contract, it is to be presumed that the parties intended to except only such share-distributions as the corporation is otherwise legally authorized to make. The permissive grant is to be read as extending only to what may be done lawfully, not as extending to what the law does not allow.¹⁰

Respectfully submitted,

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¹⁰The Circuit Court of Appeals suggests (R. 37-38, 42) that there was in any event no factual or legal obstacle to payment of taxable stock dividends, on the ground that the corporation could have amended its charter. This is plain error: a corporation may not amend its charter; only the shareholders may do that.

